INTERNATIONAL JOURNALS

OPUS PRO SCIENTIA ET STUDIUM

THE IMPACT OF CORPORATE SOCIAL RESPONSIBILTY ON CORPORATE FINANCIAL PERFORMANCE & THE CONCEPT AND ROLE OF AGENCY THEORY

International Journal of Financial Management

Vol. 16 Issue: 20, pp.2-38

April 12, 2018

Harisai Anil Kumar Doshi

Research Scholar | Author

Asia Pacific University

Vikneswaran S/O Manual

Research Editor | Co-Author

Asia Pacific University, School of Accounting and Finance

Durgashini A/P Lingadaran

Research Editor | Co-Author

Asia Pacific University, School of Accounting and Finance

Ummi Kalthum Binti Ab Mujib

Research Editor | Co-Author

Asia Pacific University, School of Accounting and Finance

To Cite This Document

Doshi, H., Manual, V., Lingadaran, D., and Kalthum, U., 2018. The Impact of Corporate Social Responsibility on Corporate Financial Performance and The Concept and Role of Agency Theory. *International Journal of Financial Management.* 16(20), pp.2-38.

ABSTRACT

The primary goal of a **corporation** should be to maximize its owners' value, but a **proprietor's** goal might be quite different. Consider **Larry Jackson,** the proprietor of a local sporting goods store. Jackson is in business to make money, but he likes to take time off to play golf on Fridays. He also has a few employees who are no longer very productive, but he keeps them on the payroll out of friendship and loyalty. Jackson is running the business in a way that is consistent with his own personal goals. He knows that he could make more money if he didn't play golf or if he replaced some of his employees. But he is comfortable with his choices; and since it is his business, he is free to make those choices.

By contrast, **Linda Smith** is CEO of a large corporation. Smith manages the company; but most of the stock is owned by shareholders who purchased it because they were looking for an investment that would help them retire, send their children to college, pay for a long-anticipated trip, and so forth. The shareholders elected a board of directors, which then selected Smith to run the company. Smith and the firm's other managers are working on behalf of the shareholders, and they were hired to pursue policies that enhance shareholder value.

Throughout this book, we focus primarily on **publicly owned companies;** hence, we operate on the assumption that management's primary goal is shareholder wealth maximization. At the same time, the managers know that this does not mean maximize shareholder value "at all costs." Managers have an obligation to behave ethically, and they must follow the laws and other society-imposed constraints that we discussed in the opening vignette to this chapter. Indeed, most managers recognize that being socially responsible is not inconsistent with maximizing shareholder value.

Consider, for example, what would happen if Linda Smith narrowly focused on creating shareholder value, but in the process, her company was unresponsive to its employees and customers, hostile to its local community, and indifferent to the effects its actions had on the environment. In all likelihood, society would impose a wide range of costs on the company.

It may find it hard to attract top notch employees, its products may be boycotted, it may face additional lawsuits and regulations, and it may be confronted with negative publicity. These costs would ultimately lead to a reduction in shareholder value. So clearly when taking steps to maximize shareholder value, enlightened managers need to also mind these society-imposed constraints.

It is at this point where the researcher extends an application of literature review onto experimenting Corporate Social Responsibility and its impact on Corporate Financial Performance. Subsequently, the researcher also stress on the importance and implications of agency theory in the context of financial management.

Keywords: Owner, Shareholder, Goal, Wealth, Responsibility, Financial, Agency.

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NOTE: *The report contains* ***bolded words*** *for easy read and* ***cursive words*** *to help keep track of main points. It also contains images of diagrams and charts to promote visual learning.*

THE IMPACT OF
CORPORATE SOCIAL RESPONSIBILITY
ON
CORPORATE FINANCIAL PERFORMANCE

A Literature Review

By: Harisai Anil Kumar Doshi

1.0 CORPORATE SOCIAL RESPONSIBILITY (CSR)

1.1 Introduction to CSR - Its concept

In financial management, according to Khurshid (2017), Querol-Areola (2017), Galant and Cadez (2017) and Bråtenius and Melin (2015) **"Corporate Social Responsibility" (CSR)** takes a step further in changing the mindset and traditional culture of the firm by giving organizations the opportunity to serve and create relationship with all stakeholders rather than merely acting in preference of shareholders by maximizing their wealth. Basically, to widen the scope of aims, objectives and goals towards **moral** and **practical** paradigms. (Mujahid and Abdullah, 2014)

Based on Khurshid (2017), Querol-Areola (2017), Galant and Cadez, CSR can be depicted as an extension of responsibility, beyond traditional and common goals of firms, in conducting activities that ethically, socially and sensitively contribute towards *social*, *cultural*, *economic* and *environmental* development that entertains **stakeholders' interests** and promotes **society's wellbeing** at large. The activities could be donations, community sponsorship, investments to stop pollutions and employee benefits. (Bråtenius and Melin, 2015)

This situation explicitly implies how company structures its policies and practices and goes beyond *legal obligations*, *complianc*e and *company's interests* to engage in social causes.

Thus, CSR concept dictates the importance of organizations to consider the **interests of society** by taking responsibility for the impact of their activities on *customers, employees, shareholders, community* and the *environment* in all aspects of their operation.

These concept and objective of CSR shall be evident when organization's activities meet or exceed stakeholder's expectations.

1.2 Introduction to CFP- Its Concept

“Corporate Financial Performance” (CFP) depicts the ability of companies to utilize its assets to produce revenue. Thus, it refers to overall financial status of the firm in monetary terms of investment returns, return on assets and added value, over a period of time. These measurements assists in creating distinctions with businesses in similar industry. (Khurshid, 2017)

1.3 CSR and CFP Relationship

Khurshid (2017), Querol-Areola (2017), Galant and Cadez (2017) and Bråtenius and Melin (2015) argue that there is a significant relationship that connects CSR to CFP where it can be seen that firms with communitarian ideology that indulge in CSR practices experience higher CFP compared to firms with individualistic ideology who purely invest time in maximizing shareholder wealth. This shows that CSR positively and negatively impacts CFP.

This is because, CSR can be seen through dual views where some managers view additional expenses of CSR as an ethical investment that invites competitive advantage whereas others view it as expenditure that reduces profitability creating competitive disadvantage. (Mujahid and

This is where the main problem lies, misinterpreting their entire concept of CSR- where CSR activities are supposed to be undertaken as long-term ethical and profitable investments rather than short term additional cost and expenditure burden- as it exists on the motive of creating betterment of society before improving CPF. Thus, Galant and Cadez (2017) believe it should be perceived in the positive side as its benefits overpowers its limitations.

However, Cheng, Ioannou and Serafeim (2018) and Khurshid (2017) argue that firms fail to understand how CSR positively impacts financial long-term performance due to trade-off between expenditure in CSR and profitability. This creates the importance of reviewing the literature of the positive and negative impact of CSR on CFP.

1.4 Factors that contribute to Positive Relationship

Many researchers argue that CSR positively impacts CFP in the long run depicting firm's profit maximizing CSR perspectives. The reason being:-

1.4.1 Freeman's Stakeholder Theory

The paragraph below can be supported by **"Freeman's Stakeholder Theory"** developed in 1984 but supported and evaluated further by Galand and Cadez (2017), where the theory emphasizes that managers must act in interests of all stakeholders and not just fulfil shareholder wealth maximization goals.

This is because stakeholders are individuals with stake in the company and opposing their satisfactions can drastically and negatively deteriorate company image diminishing competitive advantage and reducing CFP.

Therefore, if companies practice CSR, it could encourage shareholder engagement that positively impact CFP. For example: employee satisfaction shall encourage high productivity, customer satisfaction shall promote product loyalty and word-of-mouth promotions and suppliers may give discounts- increasing overall CFP. (Galant and Cadez, 2017)

First**, stakeholder engagement and trust**. Galant and Cadez (2017) opines that the ideology of companies practicing CSR activities shows how the business is concerned and prioritizes objectives of groups other than shareholders and is willing to take a broader and longer view than their own short term profits. This shows the effort to create and be the change despite the CSR costs that may incur- clearly showing the genuineness to entertain society's betterment.

So, Bråtenius and Melin (2015) adds that this positively impacts stakeholder's perception towards originations goals and culture as they are unable to imagine anything immoral when companies are being socially responsible.

Thus, Khurshid (2017) supports dictating that stakeholders tend to develop greater trust and loyalty; especially consumers who begin supporting firms' by repeatedly purchasing their products- as they are confident towards the organization's ethical goals that cater better company image and reputation.

Over time, companies are able to take advantage of CSR by charging premium prices and selling greater amount of their product and services- which indirectly offsets high CSR costs.

This way, benefits exceeds cots allowing companies to see their profits inclining above average- clearly showing positive relationship between CSR and CFP.

Second, **professional and personal development**. The implementation of CSR changes corporate culture and operations in which most of the tasks in the organization shall be geared towards following the ethical code of conduct. (Khurshid, 2017)

To achieve this, every employee shall receive opportunity to undergo CSR training and development in order to successfully indulge in CSR activities. Based on Galant and Cadez (2017) and Querol-Areola (2017), this increases their efficiency and effectiveness as they tend to develop new skills and methodologies of executing tasks that can be applied throughout the organization.

Also, Mujahid and Abdullah (2014) believe that employees may become better in their job as the essence of CSR may include work aspects which employees are passionate about- encouraging them to showcase greater interest and loyalty towards adapting the CSR culture of organization.

This creates motivation to work efficiently and effectively that may allow company growth and brand image increasing CFP.

Third, **voluntary disclosure.** According to Galant and Cadez (2017),) Bråtenius and Melin (2015), Cheng, Ioannou and Serafeim (2018) and Querol-Areola (2017), CSR builds confidence in managers to prepare and record financial statements in true and fair view despite high CSR costs may reduce profitability figures initially.

This is because, they are inspired to showcase their efforts and sacrifices contributing for society's betterment. Thus, Khurshid (2017) supports dictating that companies tend to deliver greater voluntary disclosure which indirectly motivates investors to invest as they gain trust in the company and see lower profits as the beginning of greater CFP in future.

This is because they see greater CSR expenditures as prudent, and intelligent investment decisions which could push up the price of stock in the near future- allowing them to maximize shareholder wealth.

Thus, Galant and Cadez (2017) opines that investors are willing to support CSR investments as they believe that 'risk requires reward.

This indirectly serves as a competitive advantage for firms as their goals of CSR is able to invite investors despite initial profit deterioration.

Not only that, a continuous commitment to social contributions shall reduce transaction costs and boost market opportunities- allowing businesses to prolong their competitiveness national and internationally. This, over a period of time elevates the CFP. (Khurshid, 2017)

Fourth, **intellectual capital (IC),** according to Khurshid (2017), can be defined as an intangible asset that resembles company's main informational source which possesses the capability to create and develop new product, maintain and attract new and existing customers and increase profits. It is the ultimate source that contains every possible confidential information regarding how the company developed business improvements.

Thus, IC happens to be an invaluable intangible asset that can collectively improve corporate performance by delivering innovation ideas, value creation opportunities and enhancing employee's creativity. IC is composed of three efficiency elements, namely, 'human capital', 'structural capital' and 'capital employed'. (Khurshid, 2017)

In this context, it is argued that CSR plays vital role in enhancing and developing IC as both practices show common interest. Therefore, the essence of CRS that encourages engagement with internal and external shareholders displays implementation of various different skillful actions that are in the form of 'intangible resources'.

These sophisticated actions may be secret formulations developed out of employees and management's experiences- which are important to the concept of IC. (Khurshid, 2017)

Thus, CSR practices resemble main contributors to the development of IC in terms of human capital, structural capital and organization's reputation.

So, IC enhancement creates future economic benefit by reducing productions costs and increasing asset and equity returns due to firm's secret formulations and theories that are able to improve reputation which promotes brand name and brand image. This increases competitive advantage, profitability and CFP. (Khurshid, 2017)

1.5 Factors that contribute to Negative Relationship

In contrast, many authors argue that CSR negatively impacts CFP in the short-run depicting firm's profit maximizing traditional perspectives. The reason being:-

First**, cost burden**. In financial management, according to Galant and Cadez (2017) and Bråtenius and Melin (2015), the ultimate and traditional goal of every firm is to maximize profit where every decisions and practices must contribute to profit motive, if not, those practices shall be eliminated from the organization.

Thus, Cheng, Ioannou and Serafeim (2018) believes, the concept of CSR may look like it involves merely moral and social practices that should be implemented within the decisions of the organizations when it actually involves additional costs for its implementation to be effective. This may contradict with the profit motive of organizations as CSR's additional expenditures appear to be a financial burden that, in near future, can significantly reduce profits and so the CFP. (Galant and Cadez, 2017)

Second**, agency relationship**. Based on Bråtenius and Melin (2015), CSR negatively interferes with principal-agent relationship where agents are required to act in accordance to shareholder's interests but often oppose this responsibility due to conflict in interest. Instead, agents tend to maximize personal wealth.

This situation clearly shows that if managers are not willing to maximize shareholders wealth, obviously they shall not entertain CSR especially when CSR incurs additional costs and that managers are focus in creating personal gain. Self-interested managers shall seldom prefer to practice CSR as they are more interested in short-term financial profits than uncertain long term profitability.

Also, Bråtenius and Melin (2015) adds that, if managers acted in accordance with shareholders' interests, since they are 'agents', they shall only maximize shareholders wealth and shall have no mandate to apply CSR when it goes against shareholders maximization goals. This shows how CSR, if applied, may put company in a competitive disadvantage- negatively impacting CFP.

Third, **time and advertisement**. CSR may take long duration of time to bring in positive results on CFP and to create positive company image unlike advertisements. Hasan et al. (2016) Often, the spending on CSR may display lower profits, thus leaving businesses to experiencing possibilities of not having any image.

This is because the amount spent of CSR reduces amount left for advertising. Thus, to create image and earn profitable status in short term, companies may often spend on advertising to create good image in customers mind. This shows how CSR may not be a fast way to improve profitability, thus negatively impacting CFP. (Bratenius and Melin, 2015)

Fourth, **scarce resource**. According to Hasan et al. (2016), Bråtenius and Melin (2015) and Kolisch (2015), the idea of implementing CSR in business show that businesses now have additional goal over and above shareholder wealth maximization- where CSR may not just be an internal organizational practice but an external practice of business indulging in social services and stakeholder’s social affairs.

Thus, Bråtenius and Melin (2015) adds that if CSR practices widen with everyone encouraged to perform social responsible activities, there is high chances of unknowingly misallocating and misappropriating scare resources.

Therefore, misuse of factors of production that are limited in supply may cause scarcity to fulfil the wants and needs of customers. This may result in companies suffering from opportunity cost- that if any of the decisions are taken wrongly, it can tremendously affect CFP. The decreasing FP shall cause stakeholders to switch to other firms who may be more profitable- further influencing CFP.

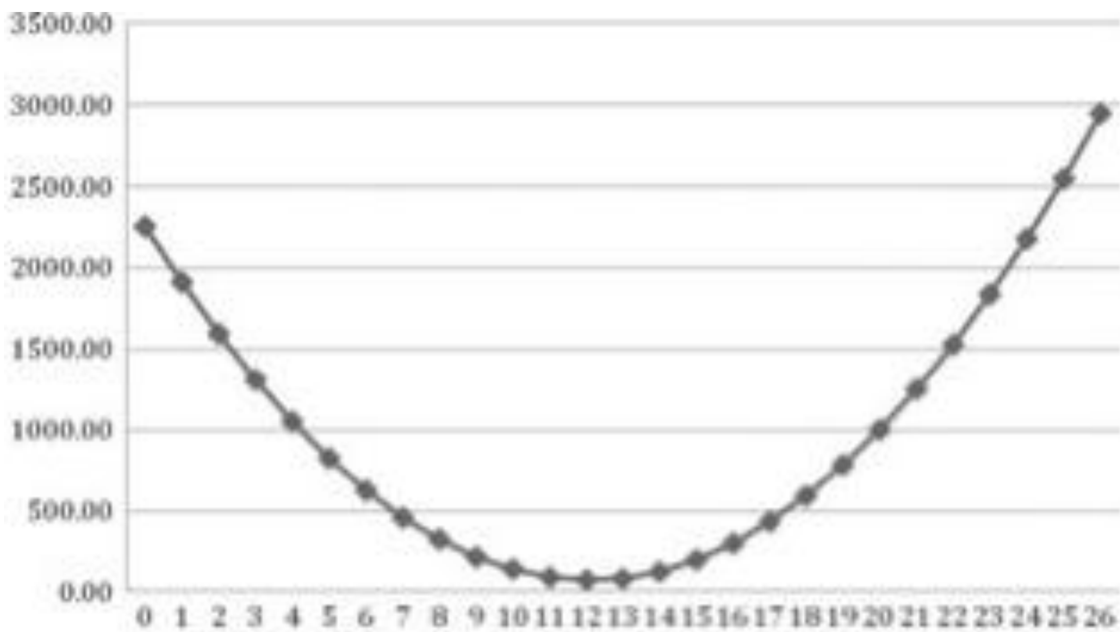
Fifth, **publicity and scrutinization**. According to Bråtenius and Melin (2015), intensive and long-term practice of CSR in organizations may improve the company image widely that ‘going green’ or ‘being socially responsible’ shall be the terms used by societies to address the organization. This means the company shall be popular in behaving ethically in the eyes and attention of society.

As a result, Bråtenius and Melin (2015) evaluates that there are high chances for the company to face journalists, reporters and media. At this level of publicity, if at all the company becomes a suspect of ‘insincerely being socially responsible’ where promoting CSR was just a medium to improve image and boost stakeholders confidence, or, happens to make a mistake by ‘not performing ethically’; for example: mistake of harming animals and discreetly polluting river- then, this aspect of CSR shall destroy company’s image, reputation and profitability drastically impacting CFP. Thus, a company that does not practice CSR may be free from these treats.

1.6 Barnett and Salomon’s U-Shaped Theory

Based on financial and strategic management, in 2012, Barnett and Salomon developed a “U-shaped theory” in summarizing all the possible relationships between CSR and CFP. This theory was supported and implemented by Galant and Cadez (2012) who dictated four statements:

- **High CSR performance have the high CFP.**
- **Low CSR performance have low CFP**
- **High CSR performance have low CFP**
- **Low CSR performance have high CFP**



Source: Boaventura, Silva and Bandeira-de-Mello (2018)

The U-shaped curve above is just an example of how Barnett and Salomon's U-shaped theory works. The horizontal X-axis of the curve from numbers 0 to 26 represents CSR performance values whereas the Y-axis from numbers $0 to $3500 represents CFP values. Please be noted that these values and the curve is just an 'example' to illustrate and further explain the U-shaped theory.

Thus, the "LEFT SIDE" of the curve from numbers 0 to 11 and $0 to $2250, shows how high CSR have low CFP and how low CSR have high CFP- **"NEGATIVE RELATIONSHIP".** For example: based on the curve, if the CSR is 8, the CFP is approximately $400 but if the CSR is 1 (reduced by 7), then the CFP is approximately $1900 (increased by $1500).

In contrast, the 'RIGHT SIDE" of the curve, on the other end, from numbers 13 to 26 and $0 to $3000, shows how high CSR have high CFP and how low CSR have low CFP- **"POSITIVE RELATIONSHIP**". For example: based on the curve, if the CSR is 26, the CFP is approximately $3000 but if the CSR drops to 18 (reduced by 8), then the CFP is approximately $600 (reduced by $2400).

This is a simple way of explaining how CSR and CFP can have a positive and negative relationship. Please be noted that there can be several other relationships that can be derived from the curve above, however, this literature review is only concern with positive and negative relationship to prove how CSR can positively and negatively impact CFP.

CONCLUSION

It can be evaluated that CSR has positive and negative impact on CFP. However, the main theme that can be obtained from this literature review is that CSR is a modern concept and can be made as a modern financial goal compared to traditional goal of shareholder wealth maximization. The goals at the end of the day do create and generate profits, but the duration of time and the technique may be different.

Here CSR may take longer time to generate profit and spread awareness of its importance to its stakeholders, but, managers should treat is as an investment rather than an unnecessary expenditure.

It is very important for managers to understand the concept of CSR. This is why this topic has been chosen as it is a vital area that deserves discussion including views and opinions of various authors.

AGENCY THEORY

A Literature Review

By: Harisai Doshi

Area of Discussion: Do Agents Act in Accordance to Principal's Interests?

2.0 AGENCY THEORY

2.1 Formation of Agency- Its origins

In this context of financial management, according to Borrington and Stimpson (2013), large business organizations such as public limited companies possess opportunities to raise large sums of capital through issuance of shares that are purchased by large number of shareholders.

Keown, Martin and Petty (2017) opine that this makes shareholders, owners of the company, who have ability to handle ownership and confront risks and returns of their shares but inability to participate in strategic and operational decision making, managing, running and controlling the business. Thus, shareholders elect directors and managers to perform these responsibilities on their behalf- creating **divorce** between **ownership and control.** (Borrington and Stimpson, 2013)

This separation shows an imperative *contractual relationship* between shareholders and managers; depicting the existence of **'agency'** present - which is in the form of an **'Principal-Agent' relationship** better known as **'Agency Relationship'.** (Brigham, Houston and Sandburg, 2007)

2.2 Agency Relationship and Emerging Agency Problem

Based on Ng (2010) and Ross (2007), a**gency relationship** finds its roots from the widening gap between 'shareholder's ownership' and 'manager's control responsibilities'- where it can be defined as the arrangement in which one party known as **'principal' (shareholder)** appoints or hires another party knows as **'agent' (manager)** to act in accordance to their interest, under **contractual agreement.** This correlation of principal and agent itself resembles **'agency'.**

Keown, Martin and Petty (2017) adds that, under this circumstances of **agency agreement,** managers are required to position goals of shareholder as their primary objectives. However, this is not always the case as managers often perform opportunistic actions contributing towards their personal interests- at the expense of shareholders.

This explicitly depicts **'conflict of interests'** due to the different objectives- when shareholders' aim *'shareholder wealth maximization'* whereas managers' aim '*personal wealth maximization'.* (Ng, 2010)

Thus, this **non-congruent diverging goals** form the foundations of **'agency problem'** which pictures managers in the organization as *'wealth seekers and risk averse'* unlike principals who are *'profit seekers and risk neutral'.* (Ng, 2010) This scenario marks the emergence, development and intervention of **'Agency Theory'.**

2.3 Agency Theory and Area of Discussion

According to Panda and Leepsa (2017), Ng (2010) and Brigham, Houston and Sandburg (2007), **agency theory** represents the oldest model in the literature of management and economics- which intensively studies and explains the principal-agent relationship, agency problems, agency costs and suggests imperative remedies that realign both party's interest to mitigate problems. However, this theory concentrates more on the agent's side in terms of agent being the problem maker rather than principal.

Ross (2007), Brigham, Houston and Sandburg (2007) and Ng (2010) in financial management, agency theory pertains to two types of 'principal-agent' relationships, namely: 'shareholder and managers' and '’shareholders and creditors'.

However, the following paragraphs shall concentrate on 'shareholder-manager relationship' in terms of critically discussing the various views of many authors towards "**factors that contribute to agency conflict and factors that mitigate agency conflict'** through the model of agency theory.

2.4 Factors Contributing to Agency Conflicts

Many authors argue that managers **do not** act in accordance to shareholder's interests. The reason being:-

First, **separation of ownership and control and diverging goals.** Keown, Martin and Petty (2017) and Panda and Leepsa (2017) argue that the goal of the firm is to maximize shareholder wealth where managers are hired to achieve this for shareholders.

This shows separation between owners and managers where the managers are just agents to help shareholders achieve their goals, but shareholder's goal is not manager's goal. (Panda and Leepsa, 2017) So, this shows both parties having different goals with managers running the firm according to their personal goals, interests and desires such as maximizing their own wealth in terms of salaries, fringe benefits, perquisites and number of share options at the expense of shareholders.

Smith (2011) adds that this behavior is an outgrowth of basic human trait that strives to maximize personal gain out of rationality and motivation. As a result, separation fails shareholder in monitoring agents and achieving wealth maximization-contributing to agency conflict.

Second, **risk preference.** Ross (2007), Panda and Leepsa (2017) and Smith (2011) argue managers are in positions where their income level is decided by company performance. This encourages them to run the company in risk- free methodology by diversifying money into different asset classes and investment products, minimizing risky investments, stock risks and financial leverages. (Keown, Martin and Petty, 2017) This reduces the possibility of bankruptcy and managerial capital loss- improving company performance and managers employment continuity.

In contrast, Keown, Martin and Petty (2017) opine that this risk averse attitude may not be in favor of shareholders who are often risk neutral. This is because shareholder belief 'risk requires reward' and that risky investments possess high possibilities of increasing their share value. (Keown, Martin and Petty, 2017)

However, Brigham and Houston (2009) evaluates that since managers are elected to run the company, their decision to object risky investments causes shareholders to lose profitable opportunity- leading to agency costs. This shows how both parties possess different risk exposure- creating conflict.

Third, **moral hazard** implies self-satisfying actions discreetly taken by managers without shareholders knowledge; knowing the costs of risks shall be borne by shareholders. (McClogan, 2014)

Thus, Panda and Leepsa (2017) support dictating managers are inspired to inconspicuously invest according to personal skills that cater for personal gains due to having lower or no ownership and lesser motivation to invest and maximize shareholders wealth. McClogan (2014) argues this self-interest investment may increase the significance of managers towards the company, allowing them to claim higher yield as they are irreplaceable.

Thus, self-centered managers often take advantage of moral hazard to cater for personal benefit at the expense of shareholders- creating difficulty in monitoring these actions as they are discreetly performed; thus elevating agency costs. (Panda and Leepsa, 2017), (Smith, 2011) and (McClogan, 2014)

Fourth, **retained earnings**. Based on McClogan (2014) and Ng (2010), managers are often diverted from the goal of maximizing shareholder wealth to focusing on business growth- because larger business size generates higher earnings that can be reinvested into business core for future investment projects rather than being paid out as dividends to shareholders.

Borrington and Stimpson (2013) adds that business growth allows managers to control a bigger and well-known business that grants greater power, status and sovereignty- awarding them higher remuneration and job security for the great work that they do.

However, McClogan (2014) and Smith (2011) argue that this aim of business diversification conflicts with shareholders as they prefer to be paid dividends rather than having it retained. This is because, diversification reduces returns and value of the firm- damaging overall shareholder wealth. But, agents continue to support business growth although it harms principal interests as prestige is substantial. (Ross, 2007), (Brigham, Houston and Sandburg, 2007) and (Ng, 2010)

Fifth, **information asymmetry**. Borrington and Stimpson (2013) argue that managers possess the authority to plan, organize, coordinate, command and control the entire management by taking important decisions at every interval.

Thus, McClogan (2014) supports dictating they are individuals thoroughly indulged in business management activities- where they are aware of every aspect, update and performance information of the business. In contrast, McClogan (2014) also argues shareholders own the business and await every opportunity to maximize their wealth- but are unaware of business decisions and performance unless informed by managers.

Often, owners are not informed or the information does not reach them causing information asymmetry. (Panda and Leepsa, 2017) This increases the possibilities of conflict in agency relationship.

Sixth, **duration of involvement**. Based on Keown, Martin and Petty (2017), the employment turnover of managers may be higher than shareholders who possess business ownership. Due to the short term of employment, managers are only interested in the short-term returns conflicting with shareholders who are anxious to know future cash flows. (McClogan, 2014)

Thus, managers tend to maximize personal wealth and executive compensation by manipulating earnings and reducing R&D expenses before retirement- which is all against prime goal of businesses. This creates conflict and increases agency costs. (McClogan, 2014)

2.5 Consequences of Agency Conflict

The reasons of managers not acting towards shareholder's preferences leads to negative consequences known as **'agency costs'.**

Agency costs can be depicted as the costs borne by shareholders due to agency conflict. This cost can be divided into two categories, namely: **'indirect costs'-** which refers to the best alternative forgone due to managers minimizing share value and **'direct cost'-** which occurs in two practices namely **'corporate expenditure'** and **'monitoring, bonding and residual loss.** (Brigham, Houston and Sandburg, 2007)

"Monitoring costs" are expenses incurred by shareholders for observing, accessing and supervising manager's appraisal in the business. These may include supervisors' payment, board of director's maintenance, appraisal and behavior analysis and compensations. Also, manager's recruitment, development, training expenses come under monitoring costs. (McClogan, 2014) **"Bonding costs"** are expenditure incurred in designing specific framework which guides managers to operate according to company's systems. This binds managers to display commitment towards the contractual obligation to agency relationship- indirectly limiting their self-interest activities. For example: compulsory recording and preparation of financial statements and mandatory distribution of dividends opposing actions of retaining earnings. Monitoring cost decrease as bonding cost increase. (Brigham, Houston and Sandburg, 2007) and (McClogan, 2014)

"Residual Loss" is cost incurring out of agency losses over and above monitoring and bonding practices. For example: managers still taking self-interested decisions. So, to keep residual loss lower, monitoring and bonding cost have to be used. (Brigham, Houston and Sandburg, 2007)

2.6 Factors Mitigating Agency Conflict

In contrast, many authors argue that managers have significant incentive to act in shareholders' interests. The reasons being:-

First, **Provision in company act**. According to Ng (2010), The Malaysian Company Act 1965 requires mangers to prepare financial statements and get it audited by independent external auditors. This is so that the auditors shall communicate and inform shareholders regarding the company's performance and that if the financial statements' are reliable, relevant and presented by managers in true and fair view.

Panda and Leepsa (2017) adds that the idea of auditors being a middle man in this situation indirectly compels managers to act in shareholders' interest as every act of manager shall be reflected in financial statements.

Also, the act encourages firms to carry out Annual General Meetings (AGM) to allow shareholders be fully aware about the company by asking questions regarding firms activities and managers decisions. This is so that shareholders can eliminate information asymmetry and accordingly employ or terminate managers to improve agency relationship. (Ng, 2010)

Second, **managerial compensation and ownership**. Managers are required to be fairly compensated in return of managing and controlling the company in the name of 'going concern'.

Ng (2010) and ross (2007) argues that despite various different compensation packages, every manager deserves to receive 'annual salary' that funds living necessities and basic expenses; 'year-end bonuses' according to performance and profitability of company and 'opportunity to buy shares and be part of company's ownership' which recompenses for continuing performance.

This best compensation shall be allowing managers to buy shares because indirectly this shall motivate them to maximize share value knowing they resemble part of firm's ownership. (Ng, 2010)

Thus, often managers are awarded 'performance shares' on basis of company performance or 'executive stock options' allow them to buy shares at given price in future. This way, shareholders shall succeed retaining and attracting managers- reducing gap between diverging interests. (Ng, 2010)

Third, **information flow**. According to Ng (2010), the Securities Commission and Bursa Malaysia requires shareholders to perform 'management appraisal' by establishing internal audit committees and effective audit and financial reporting, so that company's annual report can address risks, solutions to risks and current and expected company performance details.

Despite managers practicing information assesmtry, this way, shareholder shall be timely notified information that could help them evaluate manager's performance and make recruiting-dismissal decisions effectively.

Fourth, **linking management remuneration to shareholder wealth**. Mangers are given 'yearly performance objectives' such as increasing sales and profits, where, if these targets are exceeded, then managers shall be rewarded with inclining remunerations as they succeed elevating company performance. This way, managers are anticipated to maximize shareholder wealth in attempt to increase personal wealth. (Ng, 2010)

Fifth, **selling shares and threat of takeover**. In large companies, self-interested managers that escape shareholder monitoring out of ingenuity are at high risk of having major shareholders such as insurance, government investment and pension funds, disposing shareholdings. The disposal of shares drastically reduces share price making firm vulnerable to takeover. The process of takeover shall automatically dismiss all managers upon appointment of new management causing loss of employment. This implies the essence of deterrence applied in aligning agents towards principal's goals. (Ng, 2010)

Sixth, **threat of firing** resembles another deterrent factor where managers are at the verge of getting ousted if they begin intensively controlling shareholders voting mechanism. This happens when diversification of firm attracts many shareholders and under control of managers are unable to vote against managers. (Brigham, Houston and Sandburg, 2007) Thus, to overpower managers control authority, shareholders have begun firing managers especially if company performance is deteriorating. This is evident with Yahoo, Xerox and Coca-Cola when they were ousted after being CEO for short time. (Ng, 2010)

CONCLUSLUSION, POINT OF VIEW and OPINION

Based on the literature review designed for the motion: "Do Agents Act in Accordance to Principal's Interests?" it can be explicitly evaluated that many authors are against this statement whereas many favoring the statement.

These contradicting views of authors emerge due to the different perspectives and perception used in looking at how agency theory addresses the problem and brings solutions to mitigate the conflict. Thus, this entire literature review is written on the grounds, essence and context of agency theory but the content is a compilation of literature reviewed from the critical views and opinions of authors who delivered their understanding and interpretations through legitimate journals.

Based on the critical findings above, it can be evaluated that the concept of agency emerged for the basic delegation of authority and responsibility to run an organization in a systematic and efficient manner. However, conflicts of interests between two different parties created problems of agent objecting to perform for principal's interest due to self-interest. This develops agency costs.

However, the cause of the problem can be mitigated. This shows that agents may go off-tract but can be trained to act in principal's interests through implementation of agency theory. This becomes the sole reason for reviewing the literature where agency problems in organizations today deserved to be understood and solved to maximize shareholder and managers wealth and cater for better business and economic prosperity.

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